SMEs Business Optimism Survey

Q1 - 2013

AT A GLANCE

- The composite Business Confidence Index for the SME sector in Q1, 2013 is at 119.40 points with a y-o-y gain of 7.2 points and a q-o-q decrease of 8.4 points indicating that the overall business outlook for the coming quarter (Q2, 2013) is positive.
- A bullish sales outlook reflects expansion in business activity, with 87% of the businesses expecting either an increase or no change in sales volume in the next quarter. Among the key sectors, expectations are the highest among manufacturing firms followed by trading and services firms.
- 21% of companies in the sample reported no business challenge this quarter (vs. 31% in Q4, 2012), reflecting a weakening in the ease of doing business in Dubai.
- While key business expectations of SMEs are in line with the overall business community, however the overall optimism of SMEs is observed to be higher than large companies.
- Large companies remain more optimistic in their investment outlook over the next 12 months compared to SMEs.
- Only 25% of the companies have availed bank finance; high interest rates & charges, challenges with collateral / guarantees are elicited as the key deterrents, difficulty in complying with bank documentation requirements disabling access to bank finance.

The Department of Economic Development (DED) is a Dubai government Department that has the mandate to help achieve the key strategic objectives of fostering ‘Sustainable Economic Development’ and strengthening the ‘Competitiveness of Dubai’. In order to gauge the perceptions of the business community, DED has been conducting Dubai’s Quarterly Business Survey which provides a snapshot of Dubai’s current economic activity and the outlook for the quarter ahead.

This document presents a summary of the survey conducted in the 1st Quarter of 2013 and highlights the future expectations of SME businesses in Dubai. The survey was administered to 457 SME businesses in Dubai. In addition, the survey also examines key challenges hindering the growth and development of SME businesses and summarizes their investment outlook over the coming twelve months.

METHODOLOGY

The quarterly business survey for Q1, 2013[1] was conducted on a total of 512 companies across the Emirate of Dubai. The sample included a mix of small, medium and large enterprises and ensured an adequate representation from the Manufacturing, Trading and Services sectors, in the same proportions as their respective contributions to Dubai GDP.

Distribution of survey respondents across industry groups

	Trading (166)			Manufacturing (72)			Services (219)		
	Employees	Turnover	Number of Respondents	Employees	Turnover	Number of Respondents	Employees	Turnover	Number of Respondents
Micro	< = 9	< = AED 9 mn	76	< = 20	< = AED 10 mn	17	< = 20	< = AED 3 mn	75
Small	< = 35	< = AED 50 mn	56	< = 100	< = AED 100 mn	41	< = 100	< = AED 25 mn	85
Medium	< = 75	< = AED 250 mn	34	< = 250	< = AED 250 mn	17	< = 250	< = AED 150 mn	59

From the perspective of tapping ‘business outlook’ or expectations, the survey focused on key indicators, such as *sales, selling prices, volumes sold, profits and No. of employees.* Respondents were asked to indicate if they expect an ‘increase’, ‘decrease’ or ‘no change’ in these indicators.

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[1] *For the purpose of the survey, each quarter is defined as follows: Q1 is the period between January and March, Q2 is the period between April and June, Q3 is the period between July and September, and Q4 is the period between October and December of each year.*

SME Business Confidence Index Calculations

The SME Business Confidence Index (BCI) is calculated as a weighted average score of the following 'business outlook' indicators:

- Selling Prices
- Volumes Sold
- Number of Employees
- Profits

For each indicator, 'Resultant scores' are calculated using the net balances method:
(% of positive responses - % of negative responses) + 100

For calculating the SME Composite Business Confidence Index for Dubai, the resultant scores are multiplied with their corresponding parameter weights to arrive at a weighted average Index score. The SME composite index score is finally rebased so that Q2, 2011 = 100.

BCI scores are classified in the following three groups:

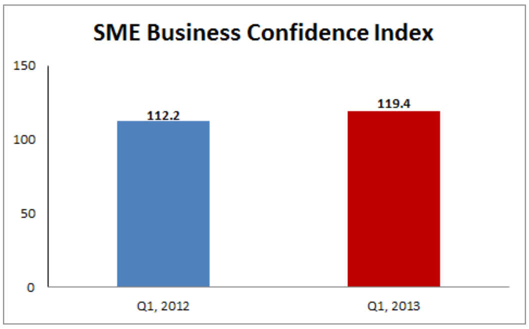
- ***BCI < 100, business expectations are negative***
- ***BCI = 100, business expectations are stable***
- ***BCI > 100, business expectations are positive***

When expressed with reference to the base quarter Q2-2011, the following interpretations hold (t and t-1 referring to two consecutive quarters:

- ***BCI(t)< BCI(t-1): business expectations are declining***
- ***BCI(t) =BCI(t-1): business expectations are stable***
- ***BCI(t)> BCI(t-1): business expectations are rising***

SME BUSINESS CONFIDENCE INDEX – Q1, 2013

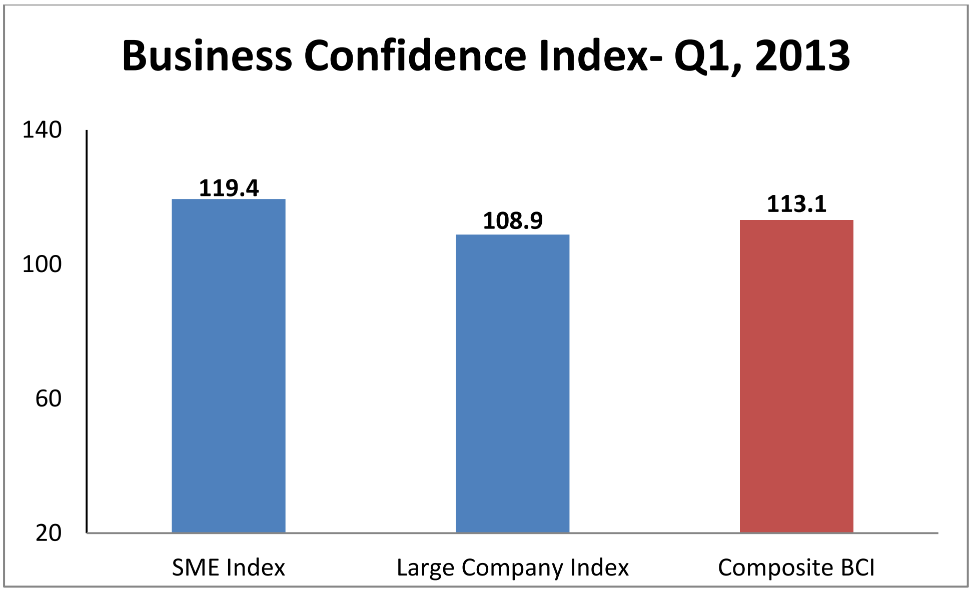
According to the IMF in its April World Economic Forecast, the prospects of an economic recovery have improved, but the bumpy recovery and skewed macroeconomic policy mix in advanced economies are complicating policymaking in emerging market economies. Until now the global economic recovery was characterized as dual speed, but according to the IMF it has now turned into a three speed recovery. In January, the IMF reduced its projection for global economic growth to 3.3% from its forecast of 3.5%, while holding out the prospect of relief late in the year. The emerging market and developing economies are still going strong, while the US is doing much better than the Euro zone among the advanced economies.



(Base Quarter, Q2, 2011)

Mirroring trends in the global recovery process, Dubai is also set to be on the growth path. According to government forecasts, the Dubai economy is set to expand 4.6% on an average between 2012 and 2015, which is more than the growth in the previous four years. Investor sentiments continue to be buoyant with positivity seen especially in the real estate and the tourism sectors. This is reflected in the rising business confidence index, which at 119.40 points, shows that the overall business outlook for SMEs in Dubai is positive for the first quarter of 2013. (A score of 100 indicates stable/neutral sentiments).

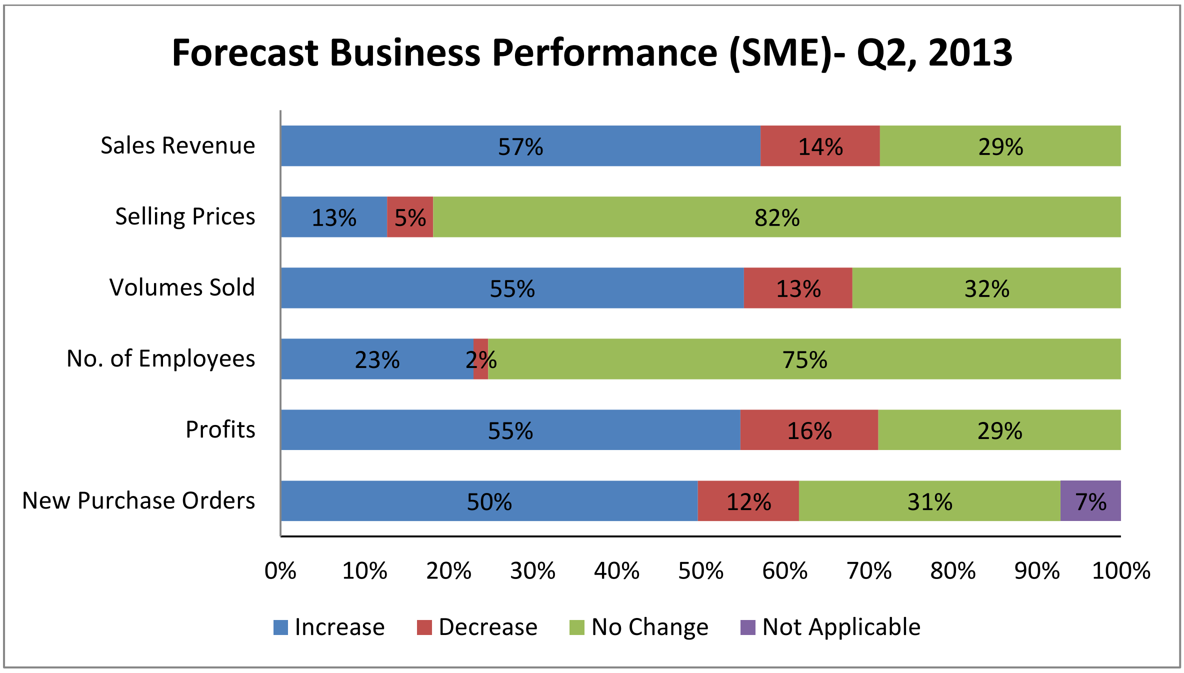
Quarter-on-quarter comparison shows that the current quarter composite index is 8.4 points lower than the index in the previous quarter. For Q2 2013, there is a surge in optimism levels for profits, volumes, and number of employees. A year-on-year comparison reveals an increase of 7.2 points over the index value during the same period in 2012.



A comparison between large companies and SMEs shows that SMEs are in the forefront in Q1, 2013; SMEs are observed to be more optimistic than large companies in this quarter, as shown by their respective index scores of 119.40 and 108.9. The higher confidence among SMEs is due to their more optimistic outlook with respect to all four parameters: volumes sold, profits, hiring and selling prices.

The UAE Purchasing Managers' Index, which measures the performance of the manufacturing and services sectors, fell to 54 points in April from 54.3 in March, and pointed to a further improvement of operating conditions in the UAE. While the April data marked the forty-fourth successive improvement, the latest reading was the lowest in five survey periods. The UAE's non-oil producing private sector companies reported a further increase in output levels in April. While new orders continued to rise sharply, the rate of increase eased to the slowest in a year. Meanwhile, employment levels rose at the fastest pace in two years.

SME BUSINESS OUTLOOK – Q2, 2013



Given the dominant share of SMEs in Dubai's total business composition (95% of the total number of firms), 457 of the 512 respondents who were interviewed as part of the survey were SMEs. These included micro, small and medium enterprises as per Dubai's SME definition.

Mirroring the expectations of the overall business community, the survey reveals relatively strong expectations for the coming quarter; with 57% of the companies expecting an improvement in their sales revenue (compared to 38% in the previous quarter) and 29% expecting no change in Q2, 2013. A year-on-year comparison reveals an improvement in the net balances for volumes sold, rising from positive 35% in Q2, 2012 to a positive 42% in Q2, 2013.

The surge in optimism sales forecast in this quarter is driven by optimistic expectations for volumes (the net balance on sales volumes stands at positive 42% compared to positive 6% for Q1, 2013). Outlook for sales volumes in Q1, 2013 has also improved when compared with the same period in 2012, with a net balance of positive 6% this year versus negative 14% last year.

A comparison between SMEs and large companies shows a reversal of trend from the previous two quarter; SMEs are observed to be more optimistic than large companies in this quarter with respect to sales revenues, as shown by their respective net balance scores of positive 43% and positive 16%. The higher optimism in SMEs is driven by a more optimistic outlook with respect to volumes, selling prices and profits.

The overall business sentiments are driven by the upbeat expectations across all sectors. While businesses in the manufacturing sector are more optimistic with respect to volumes sold, service firms have higher optimism for hiring and prices. For this quarter, expectations for volumes sold among large companies are mainly driven by the service sector, followed by trading and manufacturing sector companies.

In line with the overall business outlook, manufacturing and services SMEs are more optimistic in terms of expected sales volumes for Q2, 2013, compared to trading SMEs (positive net balance of 47% for manufacturing SMEs and 43% for services SMEs)

Within the manufacturing sector, the outlook for companies engaged in the manufacture of furniture, metals and food & beverage is very optimistic, while those in the garments and paper sub-sectors are the least optimistic. Within the manufacturing sector, 56% of the respondents expect their volumes to increase (compared to 36% to Q1, 2013), while 36% anticipate no change. A marginal 8% expects any decrease in volumes in the coming quarter. Key reasons cited include increase in seasonal demand, new projects and contracts, and business expansion in the coming quarter.

The outlook for the overall service sector has improved in Q2, 2013, compared to the last quarter. Year-on-year comparison for the overall service sector reveals a gain in the outlook for volumes sold (net balance of positive 17% in Q1 2013 and net balance of negative 13% in Q1 2012). Within the service sector, firms engaged in transport and construction are most optimistic followed by firms engaged in other sub-sectors such as restaurants, real estate, education and IT & telecom.

Among the service sub-sectors, transport firms anticipate strong business in the second quarter of 2013, due to increase in contracts and projects, higher seasonal demand, oncoming festival season and expansion of new markets. Transportation service providers also expect to get new orders for the coming festival season. Construction firms are upbeat about Q2 since they have new projects in the pipeline. Continuing demand as well as restarting of stalled projects would also lead to an increase in their business activity.

Hotels and restaurants are quite optimistic as well on their business performance in the next quarter with 44% expecting an increase in volumes. Respondents have mentioned that the increased tourist inflow as well as start of the peak business season will drive their business. Some respondents are also looking at business expansion to increase sales volume.

The survey reveals that optimism in the trading sector is lower in Q2, 2013. The net balance during Q2 stands at positive 39%, with 52% of the respondents anticipating an increase in volumes during the second quarter. Another 34% of the respondents do not anticipate any change in volumes in Q2. Key sub-sectors expecting an increase in demand in the next quarter include the following:

- Traders of computers & equipment foresee higher sales during Q2, since they are expecting more customers and clients, and have put into place business expansion plans.
- Food & beverage trading businesses as well as grocers have higher optimism on their sales performance due to plans for expansion in business, the approach of Ramadan and execution of orders already in hand. Exporters in this sub-sector are optimistic on higher levels of exports to Russia, GCC countries and Africa.

- Textile firms are anticipating strong sales based on festivals during the April-June period, introduction of new products, export opportunities to new markets in Africa.
- Building and construction traders are very bullish on their expected sales volume as they anticipate new construction projects in Oman and Qatar, they expect a decrease in prices which will boost volumes and Dubai is the central hub for the purchase of construction materials and businesses will benefit from high demand.
- Cosmetics traders have also cited increased demand due to plans for sales promotions, introduction of new brands and higher inflow of tourists, while some are anticipating higher export sales.

Sales prices will continue to remain stable in the coming quarter as well with 82% of the respondents expecting no change in the selling prices of their products and services, similar to the level in the previous quarter. However, 13% of the companies intend to increase their selling prices in the next quarter either to cover for the rising cost of raw materials or improve their profit margins by taking advantage of the festival season demand during Q2, 2013. Services SMEs (net balance of positive 10%) are more optimistic than the manufacturing SMEs (net balance of positive 6%), and trading SMEs (net balance of positive 5%) with respect to their selling prices.

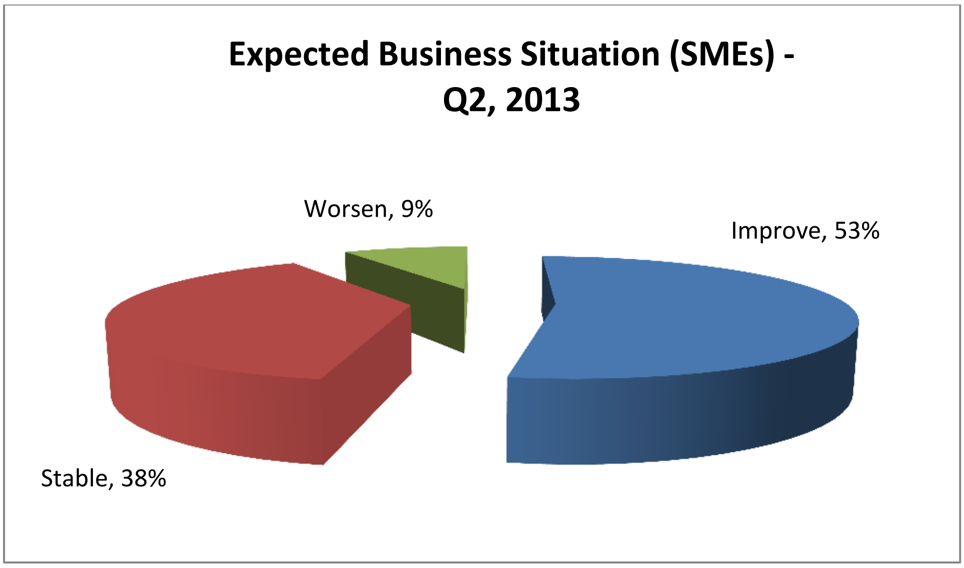
Reflecting the strong expectations on sales, a majority 50% of the SMEs are also planning to increase their new purchase orders in the next quarter, while only 12% are planning a decrease. 31% of the businesses which are planning to maintain the same level of purchase orders have said that they have made their purchases in the previous quarters and currently have sufficient stocks. Manufacturing SMEs hold a more optimistic outlook compared to trading and services SMEs for new purchase orders in Q2. SMEs hold a more optimistic outlook than large companies on new purchase orders with 50% of SMEs compared to 40% of large companies expecting an increase in the next quarter.

The outlook on hiring has improved significantly over the previous quarter, with 23% of the SMEs expecting to increase their employee count in Q2, 2013 while 75% of the SMEs expect to hold their employee count stable in Q2, 2013. Service sector firms are most inclined with respect to hiring, with 30% expecting to increase their employee count in Q2, as compared to 18% of manufacturing and 16% of trading firms. The survey also revealed that a marginal 2% of the businesses expect to decrease their workforce in the next quarter. SMEs are observed to be marginally more optimistic than large companies on hiring new employees with 23% of SMEs planning to hire additional workers in Q2, 2013.

With respect to capacity utilization, SMEs in manufacturing and services are more optimistic than large companies (net balance of positive 43% for SMEs versus a net balance of positive 20% for large companies).

The strong optimism on sales activity is also reflected in the profitability expectations of SMEs in Dubai, with 55% of the respondents expecting an increase in the next quarter. Businesses are expecting to make more profits as some are looking to get new projects or contracts, while some companies are undertaking cost cutting measures to increase their margins.

Sector-wise comparison reveals that services and manufacturing firms are most optimistic on profitability (59% and 54% respectively reporting an increase in Q2, 2013) compared to trading firms (49%). SMEs are extremely optimistic than large companies about Q2 profits, with a net positive balance of 38% for SMEs against 9% for large companies.



According to the firms' overall assessment, the business outlook for Q2, 2013 remains steady, with 91% of the respondents reporting either an improvement or stability in business conditions. A comparison between large companies and SMEs shows that the former is less optimistic about the business situation during Q2, 2013. 40% of the large companies anticipate the business situation to improve in Q2, compared to 53% of SMEs.

SME PERFORMANCE – Q1, 2013

Although the main purpose of the survey is to gauge business expectations for future activity, it also tries to capture the actual changes in business performance of SMEs from one quarter to another.

Business activity in Q1, 2013 remained strong with 37% of respondents reporting an increase in sales volumes while 33% did not have any change in volume numbers**.** Only the services sector reported a positive performance with respect to volumes sold in Q1 2013, with a net balance at positive 17%, while the manufacturing sector and trading sector reported a net balance of negative 3% and negative 5% respectively. In addition, large companies reported a much better business performance in the current quarter with a positive net balance of 24% compared to the positive net balance of 6% for SMEs.

- The positive performance of manufacturing was driven by metals, food & beverages, cement, and glass sub-sectors. However, firms producing or dealing in chemicals, furniture, garments, machinery & equipment faced a slowdown in activity due to liquidity crunch, increased competition, fewer projects and reduced consumer demand.
- The main factor accounting for a negative net balance for the trading sector was the decline in furniture business (low demand and dampened market conditions), sales in auto parts (declining demand, competition from foreign markets like China), cosmetics (reduction in number of tourists), computers and electronics (slow demand, competition), garments and textiles (seasonal trend, unrest in Iran, reduction in customer footfalls), groceries (slow business, competition), building & construction (competition, less demand) and footwear (reduced number of tourists, currency fluctuation).
- The positive performance of services in Q1, 2013 was led by an increase in activity in the following sectors: advertising (increase in demand), architecture and construction (more projects), car rental (tourism boom), facilities management

companies (more contracts), construction (increase in projects and contracts), education (introduction of new courses), printers (trade exhibitions and trade shows), real estate (improving business climate), hospitals (increase in number of patients) and restaurants & hotels (festival season, inflow of tourists.

Selling prices remained largely stable in Q1, 2013 with 67% of the respondents reporting ‘no change’. However, 19% of the respondents reported a reduction in their prices in order to boost sales in sectors that have experienced increasing competition, reduced demand and currency fluctuations.

Workforce numbers improved during Q1, 2013 with 19% of the businesses reporting that they increased their workforce during the quarter. A majority of firms (71%) however reported ‘no change’ in their employee count for this quarter. Firms in the service sector was more optimistic with 23% of the respondent in the sector reporting an increase in workforce compared to 17% in the manufacturing sector and 16% in the trading sector. Also, a higher proportion of large companies (40%) compared to SMEs (19%) reported an increase in their employee count.

Replicating the overall performance of the business community on sales volumes, new purchase orders also increased during Q1, 2013, as reflected by a positive net balance of 5%. Among the key sectors, services firms reported a positive performance with a positive net balance of 15%. On the other hand manufacturing firms and trading sector firms showed a negative net balance of 3% and 6% respectively with respect to purchase orders. Large companies reported a much better performance on new purchase orders as reflected by the positive net balance of 27% in Q1, 2013.

The unit cost of labor to businesses remained relatively stable in Q1, 2013 with 54% of the businesses reporting no change in unit labor costs. However, 45% of businesses reported an increase in labor costs and cited the following reasons – increments, bonus, incentives, increase in labor accommodation rent as well as increase in other costs of living and demand for higher salaries due to inflation.

The cost of raw materials, which has been a cause for concern for several businesses, increased for 39% of the SMEs in Q1, 2013, and it is 5 percentage points lower than in Q4, 2012 findings. Comparison between the three sectors shows that raw material costs impacted manufacturing firms the most, with 51% of the respondents indicating an increase in Q1, 2013. The corresponding number for the services sector is 34% and 30% for the trading sector. The impact of such costs affected 24% of large companies in Q1, 2013.

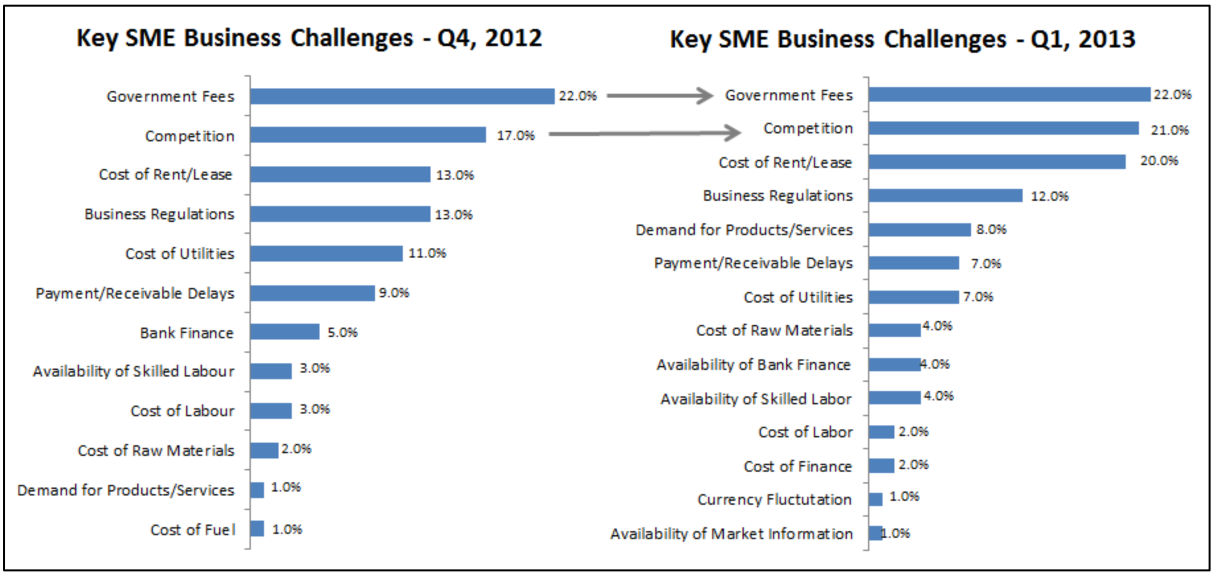
Rental costs remained steady in Q1, 2013 for 63% of the respondents, which was much marginally lower from the last quarter which showed that for 68% of respondents rents didn’t change. However, for 30% of the respondents rents increased mainly due to their annual increase in rents charged by the landlords. The impact of rental costs increases was much higher for manufacturing companies. 35% of the manufacturing companies reported an increase in rents in Q1, 2013 compared to 31% for trading SMEs and 28% for services SMEs. With respect to large companies, 27% reported an increase in rental costs in Q1, 2013.

The current quarter survey also revealed that around 40% of the SMEs availed bank finance out of which 18% reported no changes in the cost of finance and 6% reported an increase in this cost. The top reasons cited by respondents for not availing bank finance remained reinvestment of retained earnings, personal funds and availability working capital. Among the large companies, 44% availed of bank finance, of which 33% reported no change in costs, while the remaining reported an increase.

The survey revealed that 53% of the respondents reported an increase or no change in their profit levels during Q1, 2013. Service firms (net balance of negative 6%) reported better performance with respect to profits compared to manufacturing firms (net balance of negative 24%) and trading firms (net balance of negative 29%). Following the trend in the last quarter, large companies have reported a better performance on profits in Q1, 2013 compared to SMEs with 67% of the respondents indicating an increase or no change in business profits.

KEY BUSINESS CHALLENGES IN DUBAI

The survey also addressed key challenges faced, as perceived by businesses at the end of Q1, 2013. The survey shows that 21% of the businesses cited no challenges, which is a significant decrease compared to Q4, 2012 findings (31%). This indicates a strengthening in the ease of doing business in Dubai in the current quarter.



A comparison with the last quarter reveals that top 2 business challenges in Q1, 2013 are similar to those faced in Q4, 2012. However, there has been an increase in the intensity of competition while government fees have remained at the same level.

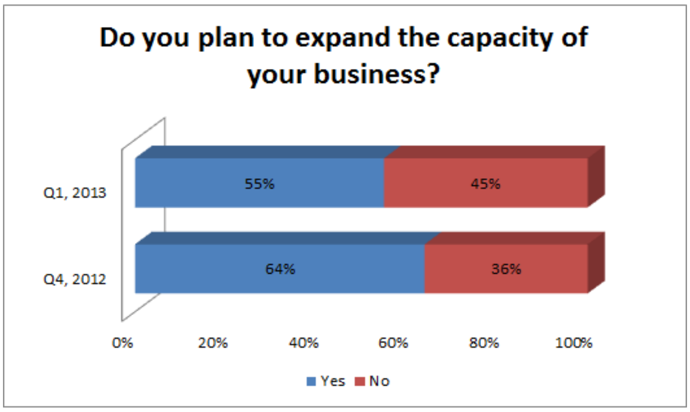
The following are found to be the major challenges impacting businesses in Dubai:

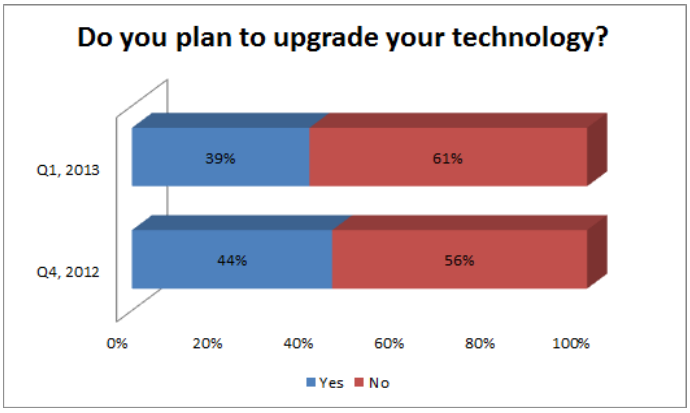
1. Government fees (*cited by 22% of the respondents):* This has been reported as the top most serious challenge in Q1, 2013. The main reasons cited are the high cost of trade license renewal and visa fees. Among the respondents that have cited this as a challenge, 47% have said the severity of this challenge had increased in the current quarter.

2. Competition *(cited by 21% of the respondents):* Competition from local and international players is the top most challenge facing Dubai businesses. Also, (43%) of the respondents that cited competition as a challenge, have said that the severity for this challenge had increased in the current quarter. This was common among all key sectors in the economy. Firms in manufacturing (cement, chemicals, food & beverage,), services (construction & travel) and trading (jewelry, furniture) seem to be the most affected by this challenge.
3. High cost of rentals & leasing *(cited by 20% of the respondents):* This was reported as an important challenge by businesses that had to renew their leases at higher rentals. Costs of rental and leasing increased for 68% of the respondents citing it as a challenge.
4. Business regulations *(cited by 12% of the respondents):* Frequent changes in business regulations (relating to business licensing procedures, import-export procedures, municipality and traffic rules). 38% of the respondents that cited business regulation as a challenge think that its severity has increased in the last quarter.
5. Demand for products/services *(cited by 8% of the respondents):* This challenge has increased in severity for 5% of the respondents that cited it as an important factor
6. Delay in payment/receivables *(cited by 7% of the respondents):* Among the respondents that cited this factor as a challenge, 44% of them said that the severity of this factor had increased in Q1, 2013.

In terms of differences across business categories, it can also be observed that challenges cited by SMEs were similar to those faced by the overall business community. On the other hand, competition is the topmost challenge affecting large companies.

INVESTMENT OUTLOOK





In comparison with findings from the last quarter survey, the outlook of businesses with respect to future expansion plans and plans to invest in technology upgrade has declined in Q1, 2013. 55% of the respondents are planning to expand their capacity Q1 2013 and 39% of firms are planning to upgrade technology (vs. 44% of the businesses in Q4 2012). Also, large companies are more willing to expand (58%) compared to upgrading technology (53%).

Businesses willing to expand capacity are planning to undertake capital investments such as expansion of the current office premises and investments in business assets such as factory, warehouse, machinery and vehicles.

Businesses with no expansion plans have cited underutilization of present capacity, insufficient funds for expansion and poor market conditions which will hamper their future plans.

Sector wise comparison shows that manufacturing (63%) and services (56%) companies are slightly more optimistic about investing in capacity expansion compared to trading firms (51%). With respect to upgrade of technology, manufacturing firms (53%) are more optimistic followed by service companies (45%) and trading firms (24%).

From a business size perspective, large businesses are more inclined to upgrading technology as well expanding the capacity of their business compared to SMEs.